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In the Supreme Court of the United States

OCTOBER TERM, 1989

VIRGINIA BANKSHARES, INC., ET AL., PETITIONERS

v.

DORIS I. SANDBERG, ET AL.

FIRST AMERICAN BANKSHARES, INC., ET AL., PETITIONERS

v.

PAUL H. WEINSTEIN, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AND THE FEDERAL DEPOSIT INSURANCE CORPORATION AS AMICI CURIAE

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QUESTIONS PRESENTED

1. Whether representations in a proxy statement about the reasons or purposes for corporate transactions, and characterizations of matters disclosed in the statement, can be materially false or misleading, and therefore actionable, under the proxy provisions of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a).

2. Whether, in a private action alleging the use of a false or misleading proxy statement in violation of Section 14(a) of the Securities Exchange Act of 1934, the allegedly misled shareholders can establish the causation necessary for recovery when they did not have sufficient votes to block approval of the transaction that was the subject of the solicitation.

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION AND THE FEDERAL DEPOSIT INSURANCE CORPORATION

The Securities and Exchange Commission is the agency principally responsible for the administration and enforcement of the federal securities laws. The Federal Deposit Insurance Corporation (FDIC) is the agency principally responsible for the administration and enforcement of those laws as they relate to the bank at issue here. The first issue in this case is whether representations in a proxy statement concerning directors' reasons and purposes for recommending approval of a particular transaction, and their characterizations or descriptions of matters discussed in the statement, can be materially false or misleading under federal proxy antifraud provisions. Although the issue arises in the context of a private damages action, the same principles of materiality apply in government enforcement

actions. The second issue is whether minority shareholders can establish that their injuries were caused by a false or misleading proxy statement used in violation of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a), when they lacked sufficient votes to block the transaction on which the vote was taken. That issue does not arise in government actions, in which causation is not an element, but is important in private actions to enforce the securities laws, and such actions serve to complement federal enforcement programs.

STATEMENT

These cases arise from a May 1987 "freeze-out" merger in which the First American Bank of Virginia (Bank) was merged into Virginia Bankshares, Inc. (VBI), a wholly-owned subsidiary of First American Bankshares, Inc. (FABI). Before the merger, VBI owned 85% of the Bank's shares; the effect of the merger was to convert the 15% minority-held Bank shares (owned by about 2,000 shareholders) into a right to receive $42 per share.

1. a. In December 1986, FABI, desiring to bring about the merger, engaged the investment banking firm of Keefe, Bruyette & Woods, Inc. (KBW), to provide an opinion regarding a fair price for the minority shares. J.A. 158-159. Jack Beddow, an officer of both FABI and the Bank, told KBW that FABI was considering a range around $40 per share for the minority shareholders.[1] Subsequently, KBW rendered an opinion that $42 represented a fair price, and it made a presentation to the executive committee of the Bank's Board of Directors. The committee recommended to the full board that FABI's proposal be accepted, and thereafter the directors voted to do so. Although VBI's 85% interest in the Bank was sufficient to approve the merger without the support of minority shareholders, the board authorized the solicitation of the minority

[1] The KBW official who signed that firm's opinion letter testified that FABI's "Jack [Beddow] had an idea around the $40 range at some point very early in the discussions." J.A. 260. See also J.A. 188-189, 191, 383-386 (although FABI's chairman had not reached a decision, FABI internally discussed $40-$42 per-share price before KBW expressed its opinion)

shareholders' proxies to vote for the proposed merger.[2] Pet. App. 5a-6a.

b. The proxy statement contained 35 pages of information about the merger and the Bank's activities. Of particular relevance here, the statement informed shareholders that the Board of Directors had approved the plan of merger as being in the "best interest of the Bank's shareholders" and set forth its recommendation that shareholders vote to approve the merger. In explanation, the proxy statement said: "The Plan of Merger has been approved by the Board of Directors because it provides an opportunity for the Bank's public shareholders to achieve a high value for their shares." The statement noted that the $42 per-share price to be paid to the shareholders was approximately 30% higher than the market price prior to the merger's announcement, and that the price represented approximately a 26% premium over book value. Pet. App. 53a-54a.

Immediately following was a section captioned "Opinion of Financial Advisor." That section stated that the Board's Executive Committee had "considered a presentation by [KBW], an investment banking firm retained by FABI to deliver its written opinion as to the value to be ascribed to the estimated 15% of the shares of the Bank not owned by [VBI]." Pet. App. 54a. Earlier in the statement, KBW was described as "an independent investment banking firm," commissioned by FABI "to pass on the fairness of the Merger from a financial point of view." *Id.* at 38a. The statement referred shareholders to KBW's opinion, which was reproduced in an appendix to the proxy statement. *Id.* at 38a, 54a.[3] It added that KBW's opinion relied upon and

[2] Virginia law provides that a plan of merger must be submitted for approval by shareholders, but does not require a proxy solicitation. A corporation is simply required to notify shareholders of the shareholders' meeting at which the plan of merger will be considered. The merger must then be approved by more than two-thirds of the votes entitled to be cast. Va. Code Ann. § 13.1-718(A), (D) and (E) (1989). When proxies are not solicited on behalf of management, the issuer must send an information statement to shareholders as required by 15 U.S.C. 78n(c). See note 40, *infra*.

[3] That opinion, addressed to FABI, stated that "[y]ou have requested our opinion as to the value to be ascribed to the approximately 15% of the shares

assumed the accuracy and completeness of information it was provided about the Bank, and that KBW "did not attempt to verify independently any such information." *Id.* at 54a. The statement disclosed that KBW was to be paid $25,000, plus expenses, for rendering its opinion to FABI, and, if the merger was consummated, KBW would receive an additional $75,000. *Id.* at 54a-55a.

2. The plan of merger stimulated several legal challenges by minority shareholders. Before the merger, some shareholders, alleging that the price was not fair to them, unsuccessfully sought a state-court injunction against the merger; the same shareholders also unsuccessfully sought an equitable appraisal in state court after the merger had been completed. Pet. App. 6a, 31a-33a.[4] Following the merger, respondent Doris Sandberg filed an action in federal district court. She alleged violations of Section 14(a) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78n(a), and FDIC Rule 12 C.F.R. 335.206,[5] and raised a pendent state-law claim that the Bank's directors had

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of [the Bank] not currently owned by [FABI]." After generally describing KBW's business and the sources of information and factors considered by KBW in formulating its opinion, the letter concluded: "[W]e are of the opinion that $42 per share represents a fair price for the shares of the [Bank] not currently owned by [FABI]." Pet. App. 74a-76a.

[4] The state court ruled that under Virginia law, holders of bank securities were not entitled to exercise statutory appraisal rights, and they did not have a common law appraisal action. Pet. App. 32a.

[5] Under Section 12(i) of the Exchange Act, 15 U.S.C. 78l(i), the FDIC's rules governed the Bank's proxy solicitation. Section 12(i) provides that the federal financial regulatory agencies shall have the "powers, functions, and duties vested in the Commission to administer and enforce" Section 14(a) (among others) of the Exchange Act, as it applies to proxy solicitations of federally regulated and insured banks and savings associations. The FDIC is responsible for insured state chartered banks that are not members of the Federal Reserve System. Section 12(i) provides that the FDIC's rules and regulations shall be "substantially similar" to those adopted by the SEC under Section 14(a) of the Exchange Act unless "implementation of substantially similar regulations * * * [is] not necessary or appropriate in the public interest or for protection of investors." The applicable FDIC rule is essentially identical to the SEC's proxy antifraud rule, 17 C.F.R. 240.14a-9.

breached their fiduciary duties in recommending the merger.[6] After a jury verdict in Sandberg's favor, the court entered judgment awarding her damages on both the federal and state claims in the amount of $43,956, representing an additional $18 per share. The court then applied the doctrine of collateral estoppel to grant the other respondents' motion for summary judgment against petitioners in the amount of $3,292,236. Pet. App. 7a-8a, 27a-28a.

3. The court of appeals affirmed the judgments in respondents' favor.[7] With respect to the Section 14(a) claim, the court held that a jury properly could have found two of the alleged misrepresentations in the proxy statement to be materially false or misleading. Pet. App. 15a-16a. The first was the representation that the board recommended the merger because it provided an opportunity for the minority shareholders "to achieve a high value for their shares." *Id.* at 53a. The court concluded that "[f]rom the evidence at trial, the jury was certainly justified in believing that the directors did not believe a merger at $42 per share was in the minority stockholders' interest but, rather, that they voted as they did for other reasons, *e.g.*, retaining their seats on the board." *Id.* at 15a.[8]

The second alleged misrepresentation concerned KBW. The court noted that the proxy statement said that FABI hired KBW "to pass on the fairness of the merger from a financial point of view"; it was disputed whether the opinion focused on fairness to the holding company or to the minority shareholders. The court remarked that KBW had relied only on the market price in valuing the stock and that other methods of analysis showed a higher value. The court also noted that "the independence of KBW was brought into question" because KBW had been told

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[6] Sandberg sought to have her case certified as a class action, but the district court denied the request for certification.

[7] The court also reversed the district court's denial of class certification in the *Sandberg* case, and remanded for entry of an order certifying a class. Pet. App. 8a-11a.

[8] In discussing the state-law claims, the court also noted that "[t]he evidence fully supports a view that the directors exercised no independent judgment whatever with regard to the interests of the minority stockholders." Pet. App. 19a.

by FABI that it considered $42 per share to be a fair price and because KBW's contingent fee arrangement gave the firm a "substantial incentive to satisfy FABI." The court concluded that the issue whether "KBW's $42 valuation was something less than the product of a completely independent analysis" was one of fact, and added: "The representation in the proxy statement that it was such an independent determination could certainly have been found to be a material misrepresentation." Pet. App. 16a.

Petitioners also argued that Sandberg could not recover because she had voted against the merger and thus had not relied on the alleged misrepresentations in the proxy statement. Pet. App. 11a-14a. In rejecting this argument, the court separately noted that this Court had expressly reserved the question whether "causation could be shown where the management controls a sufficient number of shares to approve the transaction without any votes from the minority." *Id.* at 13a, quoting *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 385 n.7 (1970). Citing *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 383 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975), the court held that causation was established so long as the proxy statement was an "essential link" in accomplishing the corporate transaction. In this case, the court noted, it was conceded that the proxy statement was "an essential link" under state law. Pet. App. 13a n.1.

SUMMARY OF ARGUMENT

I. The antifraud provisions of the federal securities laws do not, as a general rule, impose an affirmative obligation on corporate directors to disclose in a proxy statement the reason, motive, or purpose for a corporate transaction. Disclosure is ordinarily not mandated unless an omission would render the representations that are made materially misleading, or unless applicable regulations require such a statement. But if directors make affirmative representations about such reasons, either voluntarily or because disclosure is required, then their statements must not be materially misleading. Statements of

reasons, as much as statements of objective facts, can be important to investors under the materiality standard of *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976). Moreover, reasons are not immaterial simply because a proxy statement may disclose all of the "objective" facts relating to those reasons. Nor are they matters solely of speculation.

Santa Fe Industries, Inc. v. *Green*, 430 U.S. 462 (1977), does not hold that the reasons for a transaction are immaterial. There, the Court held that an alleged breach of state-law fiduciary duty, unaccompanied by deception, misrepresentation, or nondisclosure, does not state a violation of Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b). Statements that are materially false or misleading, however, are not insulated from federal liability simply because the underlying facts would also support a state-law breach-of-fiduciary-duty claim.

A false characterization or adjective, such as the word "independent," can also be materially misleading. Neither the adjective "independent" nor the broad category of adjectives and characterizations is so unimportant or so incapable of misleading investors as to be immaterial as a matter of law.

II. In order to recover for a violation of Section 14(a) in the context of a freeze-out merger, minority shareholders must show that the false or misleading proxy statement actually caused their injury. The requisite showing of causation is not satisfied simply because the solicitation was, in some sense, necessary to the accomplishment of the merger. But minority shareholders can establish causation even if their votes would not have affected the outcome of the vote for which their proxies were solicited. Minority shareholders may be misled into voting in favor of the transaction, thereby losing an appraisal remedy under state law. Moreover, misleading information may keep minority shareholders from seeking to enjoin the transaction in state court or from employing a variety of other methods to alter the transaction's terms. The proxy provisions were intended to prevent such foreseeable economic injury to minority shareholders and to work in tandem with state remedies to make the voting process effective.

ARGUMENT

I. REPRESENTATIONS RESPECTING REASONS OR PURPOSES, AND ADJECTIVES OR CHARACTERIZATIONS, CAN BE MATERIALLY FALSE OR MISLEADING

In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), this Court held that "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." The inquiry is a contextual one: it focuses on whether "disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Ibid.*; see also *Basic Inc.* v. *Levinson*, 485 U.S. 224, 231-232 (1988) (applying the *TSC* materiality standard to Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5).

In this case, the court of appeals found that two of the alleged misrepresentations in petitioners' proxy statement raised materiality questions that were appropriate for resolution by the jury.[9] In our view, while there is some ambiguity surrounding the court's application of the *TSC* test, the arguments advanced by petitioners against the submission of their challenged statements to the jury—both with respect to disclosure of directors' "motivations" or "reasons," and with respect to the use of "adjectives" or "characterizations"—should be rejected.

A. A Statement Of Reasons Can Be Material

In arguing that the jury was improperly permitted to consider whether the directors misrepresented their reasons for approving the merger, petitioners have framed the issue as whether there is a duty to disclose directors' motivations in proxy statements.

[9] Under *TSC*, the materiality issues could be taken from the jury only if they were so "obviously" unimportant to shareholders that "reasonable minds cannot differ on the question of materiality." 426 U.S. at 450. The *TSC* Court cautioned that the issue of materiality "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him," matters that are "peculiarly ones for the trier of fact." *Ibid.*

Pet. (i). There is no general, affirmative duty under the antifraud provisions of the federal securities laws to disclose in a proxy statement the reason, motive, or purpose for a corporate transaction. That, however, is not equivalent to a licence to misrepresent such matters, or to mislead shareholders about them, when a board of directors is obligated or chooses to speak.[10] If an affirmative statement about reason or purpose is made, the statement must not be materially misleading.[11] Because petitioners made affirmative representations of their reasons for recommending the merger, this is not, as petitioners seem to suggest, a case that simply involves "omissions," and that raises only the question whether there was a duty to disclose. Rather, the question here is whether petitioners' *representations* were materially misleading. In our view, Section 14(a) does not embody the principle that a board of directors' stated reasons and purposes are immaterial as a matter of law.

1. a. A statement of reasons provided by a board of directors can be highly significant to investors. Individual investors frequently lack the time, information, or expertise to conduct complex investment analyses on their own. The board of directors, in contrast, has ready access to internal corporate information and may draw upon corporate resources and advisors to analyze that information quickly and thoroughly. Directors are also charged with a state-law responsibility to exercise business judgment in the interests of shareholders, thus infusing their rec-

[10] Disclosure ordinarily is not required unless an omission would render misleading the representations that are made, or unless a "line-item" disclosure rule promulgated by the SEC (or other agency) requires a statement of reasons, purpose, belief, or basis for belief. Cf. *Basic Inc.* v. *Levinson*, 485 U.S. 224, 239 n.17 (1988) ("[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5").

[11] See *Berg* v. *First American Bankshares, Inc.*, 796 F.2d 489, 496 (D.C. Cir. 1986) ("Once the proxy statement purported to disclose the factors considered by Casey, there was an obligation to portray them accurately. • • • The drafters of the proxy statement could not legitimately attribute to Casey factors which he did not actually consider, thereby making his decision appear well-informed, and then shield themselves by arguing that Casey's subjective motivations are not material.").

ommendations and underlying rationales with an added degree of credibility from the vantage point of shareholders. If directors disclose their reasons in an inaccurate or misleading way, the "total mix" of information available to shareholders may be significantly altered. *TSC*, 426 U.S. at 449. Particularly when shareholders must evaluate the fairness of a merger transaction that will convert their shares to cash, reasonable shareholders would attach significance to a board of directors' reasons for recommending that they accept the per-share price being offered.

Numerous Commission and FDIC rules recognize the importance to investors of representations regarding reasons.[12] For example, the SEC's Regulation 14A, 17 C.F.R. 240.14a-1 *et seq.* (governing the solicitation of proxies), and Schedule 14A, 17 C.F.R. 240.14a-101 (describing items to be set forth in a proxy statement), require disclosures relating to reason and purpose for a variety of transactions.[13] Indeed, in a merger of the type FABI proposed to the Bank, the FDIC's Form F-5 required that the proxy statement set forth the reasons for the merger plan. 12 C.F.R. 335.212, Item 14(a). Similarly, Item 14 of the SEC's Schedule 14A requires the proxy statement to summarize the material features of the proposed transaction, including a description of "[t]he reasons for engaging in the transaction." 17 C.F.R. 240.14a-101, Item 14(a)(3)(ii).

Furthermore, in a "going private" transaction, in which the issuer or an affiliate purchases the issuer's securities, the Commission's Rule 13e-3, 17 C.F.R. 240.13e-3, and Schedule 13E-3

[12] Cf. 17 C.F.R. 240.13d-1(a), 240.13d-101 Item 4 (requiring statement of purpose of acquiring more than 5% of certain issuers' securities).

[13] For example, Item 11, relating to the authorization of securities for purposes other than exchange for outstanding securities in the company, requires a description of the purpose of the proposed authorization. Item 12 requires in certain circumstances that a company state the reasons for proposing any modification of a class of its securities or any exchange of outstanding securities in the company for other securities. Item 16 requires a company to state the reasons for any restatement of its accounts. Item 19 requires a company to state the reasons for any proposed amendment to its bylaws or charter. 17 C.F.R. 240.14a-101, Items 11, 12, 16, and 19. In each of these instances, the party soliciting the proxy must make an affirmative statement relating to reason or purpose.

require the issuer or affiliate to state the purpose for the transaction, the reasons for the structure and timing of the transaction, and the reasons for rejecting any alternative means for accomplishing the same purpose. Schedule 13E-3 also requires the filer to state whether it reasonably believes the transaction is fair or unfair to the public shareholders, discussing in reasonable detail the material factors upon which the belief is based and the weight given to each factor. 17 C.F.R. 240.13e-100, Items 7(a), (b), and (c); 8(a) and (b). See also 12 C.F.R. 335.409 (FDIC counterpart). Thus, in the context of a freeze-out merger, such as this one, statements about the reasons for the transaction and the directors' belief about its fairness may be quite consequential. Moreover, because the rationale behind a recommendation is commonly understood to carry influence with shareholders, directors often choose to explain their reasons, even when not required to do so.

b. Statements of reasons or purpose are not rendered immaterial simply because a proxy statement may disclose all of the "objective" facts relating to those reasons. See Pet. 16. Cf. *Milkovich* v. *Lorain Journal Co.*, No. 89-645 (June 21, 1990), slip op. 16 (noting, in a defamation case, that "[e]ven if the speaker states the facts upon which he bases his opinion, * * * if his assessment of them is erroneous, the statement may still imply a false assertion of fact."). In an analogous context under the securities laws, courts have applied the "buried facts" doctrine in recognition that accurately disclosed facts may nevertheless mislead reasonable investors if scattered throughout a document, or confusingly arranged so as to obscure their meaning.[14] Similarly, a board's misstatement of its reasons may be materially misleading to reasonable shareholders, even if a comprehensive analysis of the disclosure document would reveal the basis for questioning the board's stated rationale.

[14] See, *e.g.*, *Kennedy* v. *Tallant*, 710 F.2d 711, 720 (11th Cir. 1983) (fact that defendants had gained control through a nominal investment disclosed only through pieces of information scattered throughout prospectus); *Mills* v. *Electric Auto-Lite Co.*, 403 F.2d 429, 433-435 (7th Cir. 1968) (proxy statement set forth directors' recommendation of merger without giving similar emphasis to relationship, disclosed later in proxy statement, between directors and other company in merger), vacated on other grounds, 396 U.S. 375 (1970).

To be sure, evaluation of the "total mix" may reveal that the relevant objective facts were disclosed with sufficient prominence to render a misrepresentation of reasons or purposes obviously unimportant, and, therefore, immaterial as a matter of law. Cf. *TSC*, 426 U.S. at 450. But such manifestly inconsistent disclosures are self-deterring because they call attention to the conflict between the directors' rationale and the objective facts. Hence, only the rare proxy statement will contain a sufficient factual disclosure to render misrepresentations about reasons immaterial.

c. Nor are reasons and purposes immaterial on the theory that proving a person's "true" reasons involves too great a degree of speculation. See Pet. 16. Documentary or testimonial evidence may eliminate the need for any "speculation"; for example, the board's contemporaneous notes may establish the basis for questioning its avowed rationale. When such evidence is absent or impeached, challenging a board's statement of reasons will involve greater resort to circumstantial evidence than, for example, challenging alleged misrepresentations with respect to a corporation's earnings. But neither federal antifraud rules nor the *TSC* standard for materiality makes an exception for statements concerning reason, purpose, or belief. Moreover, the lower federal courts have developed much experience in examining such matters, without undue difficulty.[15]

At the same time, the inquiry into reasons does not subject directors to judicial psychoanalysis; courts are fully capable of recognizing evidence that is too speculative to support a finding of a violation. See, *e.g.*, *Kas* v. *Financial General Bankshares, Inc.*, 796 F.2d 508, 518-519 (D.C. Cir. 1986) (concluding that it

[15] See, *e.g.*, *Galfand* v. *Chestnutt Corp.*, 545 F.2d 807, 813 (2d Cir. 1976) (proxy statement was false and misleading when it said that a mutual fund adviser sought a new contract because of cost increases beyond his control, but failed to disclose that the depreciation of fund's net assets was another reason); *Rubenstein* v. *IU Int'l Corp.*, 506 F. Supp. 311, 315 (E.D. Pa. 1980) (summary judgment for defendants was inappropriate when a question was raised whether the motivation for a corporate transaction was misrepresented). See also *SEC* v. *Parklane Hosiery Co.*, 558 F.2d 1083, 1086-1087 (2d Cir. 1977).

was mere speculation that a principal shareholder, whose favorable valuation of the freeze-out merger price was included in the proxy statement, was motivated by a "singular desire" to wind up his affairs due to ill health and age); *Berg* v. *First American Bankshares, Inc.*, 796 F.2d 489, 496 (D.C. Cir. 1986) ("Berg's allegation that Casey did not consider all the factors in the proxy statement is based on mere speculation[.]"). Directors need not fear, therefore, that every proxy statement is open to attack on the basis of a shareholder's unsupported surmise that the board harbored "ulterior" motives.

2. Petitioners' broader contention is that misleading disclosures about reasons and purposes, even though otherwise violating the plain language of federal antifraud provisions, are insulated from shareholders' suits under *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977). Pet. 13.

a. In *Santa Fe*, minority shareholders brought suit under Section 10(b) of the Exchange Act, 15 U.S.C. 78j, and Rule 10b-5, 17 C.F.R. 240.10b-5, seeking damages for alleged breaches of fiduciary duty in the course of a freeze-out merger.[16] This Court held that a breach of fiduciary duty, standing alone, is not sufficient to violate Section 10(b); to state a claim for violation of that provision, the complaint must adequately allege that the defendant's conduct was either "deceptive" or "manipulative"—a requirement that the complaint in *Santa Fe* did not satisfy.[17] 430 U.S. at 472, 474-476. The Court

[16] The plaintiffs alleged, among other things, that the majority shareholder had breached its fiduciary duty to the minority by effecting a merger without a justifiable business purpose. They also claimed breaches of fiduciary duty in the majority shareholder's failure to give prior notice of the merger and in its payment of a price substantially less than the fully disclosed appraised value. 430 U.S. at 470-471, 473-474, 476.

[17] The complaint in *Santa Fe* did not allege that the information accompanying the notice of merger involved material misstatements or omissions; thus, the Court found that the disclosures were not alleged to be materially "deceptive." 430 U.S. at 474-475. And, finding the term "manipulative" to refer in the securities context to practices that "artificially affect[] market activity in order to mislead investors," the Court held that there was no sufficient allegation of manipulation under Section 10(b). 430 U.S. at 477.

added that a cause of action for a breach of fiduciary duty, without more, does not flow from the Exchange Act's underlying " 'philosophy of full disclosure'; once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute." *Id.* at 478. Moreover, the Court indicated, to permit shareholders to sue for a simple fiduciary breach "would be to bring within [Rule 10b-5] a wide variety of corporate conduct traditionally left to state regulation." *Ibid.*

b. Following *Santa Fe*, courts have properly dismissed actions under Rule 10b-5 or Rule 14a-9 based solely on allegations that the corporation or its directors failed to disclose improper motives or omitted mention of breaches of fiduciary duties owed to shareholders. At the same time, courts have generally recognized that misrepresentations or omissions that make disclosed facts misleading may be material, and actionable, under the federal securities laws, even when the challenged statements might also form the basis for a state-law claim of breach of fiduciary duty.[18]

Some courts, however, appear to have carried the rationale of *Santa Fe* farther than is warranted. For example, *Panter* v. *Marshall Field & Co.*, 646 F.2d 271, 289 (7th Cir.), cert. denied, 454 U.S. 1092 (1981), stated that even when defendants have made allegedly deceptive or misleading statements, "if 'the central thrust of a claim or series of claims arises from acts of corporate mismanagement, the claims are not cognizable under [the] federal [securities] law[s].' " [19] The D.C. Circuit, while rejecting

[18] See, *e.g.*, *Craftmatic Securities Litigation* v. *Kraftsow*, 890 F.2d 628, 639 (3d Cir. 1989) ("Although allegations of failure to disclose mismanagement alone do not state a claim under federal securities law, a claim that defendants failed to disclose material facts may be actionable * * * *Santa Fe* cannot be read to stay our hand in remedying violations of federal law[.]"); *Kas* v. *Financial General Bankshares, Inc.*, 796 F.2d at 512 ("We do not, however, read *Santa Fe* to preclude an action under the Securities Exchange Act based on a material nondisclosure or misrepresentation simply because the undisclosed facts involved might also support a breach of fiduciary duty claim.").

[19] See also *Kademian* v. *Ladish Co.*, 792 F.2d 614, 623-624 (7th Cir. 1986) (finding inadequate the allegation that a proxy statement's disclosure of a company's reasons for supporting a merger was misleading: "[i]f plaintiffs are correct, [the reasons given] are misleading because they are not the *true* rea-

any approach that looks to the "central thrust" of a claim,[20] and acknowledging that a misrepresentation or nondisclosure may violate federal law even if it involves a fiduciary breach, has at the same time read *Santa Fe* to imply that "liability under the federal securities laws should not turn on the resolution of essentially state-law issues." *Kas* v. *Financial General Bankshares, Inc.*, 796 F.2d at 513. Thus, the court indicated, if the "claim of material misstatement or nondisclosure" would require "a legal determination that the transaction was unfair to a minority shareholder or that an officer or director's conduct amounted to a breach of his fiduciary duty," the allegation fails to state a claim for relief. *Ibid.*[21] A third, and different, approach has evaluated the adequacy of the claim for relief by considering whether accurate disclosure could have supported a state-court injunctive remedy. See *Field* v. *Trump*, 850 F.2d 938, 948 (2d Cir. 1988), cert. denied, 109 S. Ct. 1122 (1989); *Kamerman* v. *Steinberg*, 891 F.2d 424, 431 (2d Cir. 1989).[22]

c. No clear consensus emerges from these decisions. In our view – a view consistent with most of the lower court holdings – *Santa Fe* does not suggest that a statement that is materially false or misleading is insulated from liability under federal law simply because the underlying facts would also support a

sons the majority wants the merger"); *Biesenbach* v. *Guenther*, 588 F.2d 400, 402 (3d Cir. 1978) (finding inadequate the allegation that although the board had represented that a transaction was in the "best interests" of shareholders, it had failed to disclose that the purpose of corporate loans and other activities was to entrench management).

[20] See *Berg* v. *First American Bankshares, Inc.*, 796 F.2d at 498 n.8 (criticizing that approach as requiring speculation about motives).

[21] The *Kas* court also said that a court should dismiss claims of *nondisclosure* based on allegedly omitted " 'true' motivations of the directors," because such claims "would require a court to probe the business judgment of the directors." 796 F.2d at 513. But the court did not address falsely or misleadingly presented reasons or motives of the type alleged here.

[22] Cf. *Santa Fe*, 430 U.S. at 474 n.14, discussed at note 42, *infra*. In our view, the availability of a state court remedy is more appropriately considered under the rubric of causation (see p. 25, *infra*) than in determining whether a false or misleading disclosure is "material" to a shareholder's voting decision (in an action under Section 14(a)) or to his trading decision (in an action under Section 10(b)).

breach-of-fiduciary-duty claim under state law. First, the language of the federal antifraud provisions admits of no such "reverse" preemption of the securities laws. Cf. *Adams Fruit Co.* v. *Barrett*, 110 S. Ct. 1384, 1390 (1990). The SEC's antifraud rule for proxy statements prohibits "*any* statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to *any* material fact, or which omits to state *any* material fact necessary in order to make the statements therein not false or misleading[.]" 17 C.F.R. 240.14a-9(a) (emphasis added); see 12 C.F.R. 335.206 (FDIC counterpart). A materially false statement does not fall outside the ambit of this prohibition just because it also indicates a violation of applicable fiduciary duties.[23] Second, any such extension of *Santa Fe* would greatly dilute the protection against misleading disclosure that federal law affords to investors. In many instances, false or misleading statements by directors will accompany breaches of state-law duties, for corporate misconduct often creates the incentive to avoid adequate disclosure. It would be ironic if directors could convert their violations of state duties into a shield from federal liability to shareholders who were misled by inaccurate descriptions of their wrongdoing. Third, an "exception" that extends *Santa Fe* to statements that *are* materially misleading would threaten to engulf the rule. Few allegations of false statements could not be reformulated as allegations of breaches of a state-law duty by defendants seeking to avoid liability.

Nothing in *Santa Fe* requires such incongruous results. That case did not involve deceptive or manipulative statements. Indeed, the Court distinguished lower court cases finding violations of Rule 10b-5 where a breach of fiduciary duty had "included some element of deception," 430 U.S. at 475; the Court reaffirmed the principle that "the statute provides a cause of action for any plaintiff who 'suffer[s] an injury as a result of deceptive practices touching its sale [or purchase] of

[23] Indeed, Congress intended state and federal remedies to supplement each other. 15 U.S.C. 78bb(a) ("The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity[.]").

securities[.]' " *Id.* at 476, quoting *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 12-13 (1971)[24] Moreover, the possibility of "federalizing" state corporate law that troubled the Court in *Santa Fe* is not present when the defendants' disclosures are found to be materially misleading or false. The determination that a court must make in that setting is whether directors have complied with antifraud regulations that further the "fundamental purpose" of the Exchange Act to promote "full and fair disclosure." *Santa Fe*, 430 U.S. at 478; *Basic Inc.* v. *Levinson*, 485 U.S. at 230. Making that determination does not invade or supplant state-law fiduciary duty requirements; it simply protects shareholders' access, guaranteed by federal law, to materially accurate and adequate disclosure.

3. In light of these principles, the claim here that the Board of Directors falsely or misleadingly said that the merger was approved "*because* it provides an opportunity for the Bank's public shareholders to achieve a high value for their shares," Pet. App. 53a (emphasis added), was properly sent to the jury.[25] The record, as interpreted by the court of appeals, raised an issue for the jury whether the proxy statement was false because the board approved the merger for other than its stated reason.[26]

[24] The failure to distinguish mere nondisclosure from affirmative deception has generated some confusion over the materiality of "motives" or "reasons" under the securities laws. For example, several of the cases cited by petitioners, though containing broad language, are explainable on the rationale that there is no general duty to make disclosure of reasons or motives. See *Data Probe Acquisition Corp.* v. *Datatab, Inc.*, 722 F.2d 1, 5 (2d Cir. 1983), cert. denied, 465 U.S. 1052 (1984); *Golub* v. *PPD Corp.*, 576 F.2d 759, 765 (8th Cir. 1978); *Alabama Farm Bureau Mutual Cas. Co.* v. *American Fidelity Life Ins. Co.*, 606 F.2d 602, 608, 610-611 (5th Cir. 1979), cert. denied, 449 U.S. 820 (1980); see also *Kas*, 796 F.2d at 513, discussed at note 21, *supra*. As we have indicated, the securities laws generally do not require affirmative disclosure of reasons or purposes. There is no basis, however, for insulating materially false or misleading statements by directors who speak on such matters.

[25] The jury was instructed to consider whether this statement "was false or misleading, because the claimed high values for the shares was not the reason for [the director's] approval[.]" J.A. 421.

[26] As petitioners interpret the opinion below, the court of appeals affirmed liability on the theory that even though all material facts were disclosed, the directors had a duty to disclose their "subjective motivations and beliefs." Pet.

Whether this misrepresentation was material was also a jury question. Other disclosures in the proxy tatement, such as those bearing on the directors' potential conflicts of interest, may not have been adequate to render the misstatement about the directors' reasons unimportant. If the directors acted for reasons of self-interest, the fact that shareholders were advised of that *potential* is not adequate disclosure. Since the federal proxy provisions are not ousted simply because the circumstances surrounding a misstatement might also support a state-law claim, the jury was properly permitted to determine whether this misstatement was material under the *TSC* standard.[27] See *TSC*, 426 U.S. at 450.

B. Characterizations And Adjectives Can Be Material

The second alleged misstatement, as described by petitioners, involves the characterization of KBW as "independent." Petitioners appear to contend that a characterization or adjective, such as "independent," can never be materially misleading under the federal antifraud provisions. We disagree.

1. *TSC*'s materiality requirements are not limited to subjects, verbs, and objects. An adjective or adverb used to qualify a particular piece of information may significantly color its meaning. Indeed, one of the principal issues analyzed in *TSC* was whether a claim that shareholders would realize a "substantial" premium over market values was materially misleading in light of the underlying facts. 426 U.S. at 454-460. Of course,

12-13. Quite apart from the fact that the directors' business reasons are not "subjective motives," the court never said that all material facts were adequately disclosed. What the court did say is that the jury was entitled to believe the Board acted for other than the *disclosed* reasons. See Pet. App. 14a (noting that FABI "orchestrated" the merger, and that the directors were more concerned with their own interests than those of the shareholders). Other facts discussed in the opinion support this view. See *id.* at 19a (discussing fiduciary duty claim; "[t]he evidence fully supports a view that the directors exercised no independent judgment whatsoever with regard to the interests of the minority stockholders").

[27] We recognize that there is much conflicting evidence in the record on these questions. But if, as we believe, the questions were properly submitted to the jury, the conflicts were for the jury to resolve.

some characterizations of disclosed facts are inherently too vague or inconsequential to be materially false or misleading. But the word "independent" lacks such an inherent quality.

For example, in financial accounting the word "independent," as used to describe an accountant, conveys specific and highly material information about the relationship between accountant and client and about the accountant's professional skepticism while conducting the audit.[28] Moreover, if an investment banking firm were owned by its client, a description of the firm as "independent" clearly could be a material misrepresentation.[29] A holding that the word "independent," or more broadly, all adjectives and characterizations, are not material as a matter of law would open a significant loophole in the federal scheme to protect investors against deception.

Of course, an inaccurate adjective or characterization would be immaterial when it does not "significantly alter[ ] the 'total mix' of information made available." *TSC*, 426 U.S. at 449; *Basic Inc.*, 485 U.S. at 232. In some cases, a court could justifiably look with skepticism on a claim that an inapt modifier prevented reasonable investors from reaching a balanced appreciation of the matters disclosed in a proxy statement. Moreover, in a particular case, it might be possible to demonstrate that all the objective facts were accurately disclosed in a way that

[28] Pursuant to the Commission's Regulation S-X, 17 C.F.R. 210.2-01(b), the Commission will not recognize an accountant as independent with respect to a client if, at relevant times, "he, his firm, or a member of his firm had * * * any direct financial interest or any material indirect financial interest [in that client, or] * * * was connected as a promoter, underwriter, voting trustee, director, officer, or employee." Similarly, under generally accepted auditing standards as approved and adopted by the American Institute of Certified Public Accountants (AICPA), "[i]n all matters relating to [an] assignment, an independence in mental attitude is to be maintained by the auditor or auditors." See also AICPA, *Codification of Statements on Auditing Standards*, AU § 220.03, at p. 19 (1987).

[29] Cf. *McMahan & Co. v. Wherehouse Entertainment, Inc.*, 900 F.2d 576 (2d Cir. 1990) (holding that the word "independent" was used to describe a company's directors in a misleading way).

defeats a claim of materiality based on a poorly chosen modifier. See p. 12, *supra*.[30]

2. Here, the court of appeals did not express with precision its reasons for concluding that a jury could have found the proxy statement's description of KBW to be materially false or misleading. If, as petitioners contend, the court meant to restrict its criticism of the proxy statement to the use of the adjective "independent," the result it reached was incorrect. KBW was not affiliated with FABI in the sense of common ownership or control, and, taken in context, the proxy statement's use of the word "independent" would be understood by reasonable investors to signify that KBW was an unaffiliated firm.[31] Considering the "total mix," the use of the word "independent" standing alone was not sufficient to mislead.

But in our view, petitioners' reading of the opinion is not the most natural one. The court began its discussion of KBW by quoting the proxy statement's representation that FABI had engaged KBW "to pass on the fairness of the merger from a financial point of view"; the court did not quote the proxy statement's use of the word "independent."[32] Rather, after dis-

[30] Cf. *Lessler* v. *Little*, 857 F.2d 866, 875-876 (1st Cir. 1988) (the description of an investment advisory contract as bona fide rather than a "guise" or "sham" to divert assets was not misleading in light of the full disclosure of the contract's terms), cert. denied, 109 S. Ct. 1130 (1989). Of course, the matrix of disclosed facts must be readily comprehensible to investors; as Judge Friendly noted, "it is not sufficient that overtones might have been picked up by the sensitive antennae of investment analysts." *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1297 (2d Cir. 1973). Consequently, courts have recognized that even where all of the facts are disclosed, emphasis and gloss can give rise to liability. See *Isquith* v. *Middle South Utilities, Inc.*, 847 F.2d 186, 203 (5th Cir.), cert. denied, 488 U.S. 926 (1988); *Gillette Co.* v. *RB Partners*, 693 F. Supp. 1266, 1287 (D. Mass. 1988).

[31] Moreover, the proxy statement disclosed the terms of KBW's contingent fee arrangement, which the court thought gave KBW an incentive to satisfy FABI's wishes; the statement also explained that KBW had been retained by FABI (not the Bank) and had relied on the integrity of information provided by FABI without independently verifying it.

[32] The court did say that the jury could have found the representation that KBW's valuation was an "independent determination" to be a material misrepresentation. Pet. App. 16a. But that statement, which not was not a quotation

cussing the facts surrounding KBW's relationship with FABI, the court stated that it was an issue of fact whether the $42 value ascribed to the Bank stock "was something less than the product of a completely independent analysis." Pet. App. 16a. In view of the jury instructions, see note 32, *supra*, the court's discussion, taken as a whole, is most reasonably interpreted as follows: A reasonable shareholder could have formed the impression from the proxy statement that KBW had *originated* the $42 price per share as a result of its analysis, and had expressed its opinion that this price, in particular, was fair to minority shareholders. The record, however, indicated that an officer of FABI told KBW at the outset that FABI believed that a price in the $40 per share range would be fair; KBW, in turn, believed that "any price above the market would be fair" since FABI's controlling interest gave it the power to dictate the terms of the transaction (see J.A. 259-260, 319-320, 347). Such undisclosed facts would support an inference that KBW did not so much pass on the merger's "fairness," as simply ratify FABI's desired price. In that setting, we believe it to have been a jury question whether the proxy statement's representations regarding KBW's role in the transaction were materially misleading.[33]

II. TO RECOVER FOR A VIOLATION OF SECTION 14(a), MINORITY SHAREHOLDERS MUST SHOW THAT THE VIOLATION CAUSED THEM INJURY, BUT THEY MAY MAKE SUCH A SHOWING EVEN WHEN THEY LACK SUFFICIENT VOTING STRENGTH TO BLOCK THE TRANSACTION TO WHICH A PROXY STATEMENT RELATED

In *Mills* v. *Electric Auto-Lite, Inc.*, 396 U.S. 375, 385 n.7 (1970), this Court reserved the question whether causation in a private action under Section 14(a) can be demonstrated when

of language in the proxy statement, should be read in light of the instruction to the jury that it was to consider *two* allegedly false representations: that "the proxy statement falsely stated that [KBW], the investment banking firm hired by the buyer was independent *and* had passed on the fairness of the merger." J.A. 422 (emphasis added).

[33] Again, the evidence on these points was conflicting, but the resolution of those conflicts was for the jury.

the allegedly misled shareholders could not by their votes have blocked the transaction as to which proxies were solicited.[34] Two polar positions on causation have been advanced in this case; neither, in our view, appropriately implements the purposes of the proxy rules.

On the one hand, petitioners' principal argument is that, no matter how flagrant the violation and how direct the injury, minority shareholders whose votes could not defeat a proposed transaction should never be permitted to recover. They assert that a violation of Section 14(a) causes actionable injury only if it might affect the outcome of the vote. In our view, that is too narrow a view of causation under Section 14(a). Truthful and complete disclosure may affect the ability of a controlling shareholder to consummate a proposed transaction in a variety of practical and legal ways that fully satisfy the requisite causal nexus. To deny recovery in such instances would be contrary to the purposes of the proxy rules. It would "insulate from private redress an entire category of proxy violations," *Mills*, 396 U.S. at 382—thus effectively giving management carte blanche in such cases to abuse the proxy process and deceive voting minorities.[35]

The court of appeals, on the other hand, apparently concluded that causation was established in this case on the theory that because the proxy statement was required by state law, the statement was an "essential link" in consummating the merger.[36] This formulation supports a finding of causation simply because a misleading proxy statement was issued; it does not consider whether accurate and adequate disclosure would have made a difference in whether the merger was consummated or injury suffered. Such a rule fails to satisfy the threshold requirement that the violation charged actually caused the injury.

[34] In *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 381-384 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975), the court answered this question in the affirmative. Prior to the decision below, no other circuit had addressed the question.

[35] Of course, the Commission would still be free to seek relief, but as this Court noted in *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964), "[p]rivate enforcement of the proxy rules provides a necessary supplement to Commission action," because, then as now, the SEC does not have the resources to determine the facts surrounding each of the thousands of proxy statements it reviews.

[36] As we have noted, the court's impression (fostered by the parties' concession) that state law required the proxy solicitation (Pet. App. 5a, 13a, n.1) was erroneous. See note 2, *supra*.

A. Nonvoting Causation Theories Are Consistent With The Purposes of The Exchange Act

1. The determination whether minority shareholders may permissibly show causation in seeking recovery under Section 14(a) must be made in light of the purposes of that provision.[37] As this Court explained in *Mills*, 396 U.S. at 381:

> § 14(a) stemmed from the congressional belief that "[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange." H.R. Rep. No. 1383, 73d Cong., 2d Sess., 13 [(1934)]. The provision was intended to promote "the free exercise of the voting rights of stockholders" by ensuring that proxies would be solicited with "explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought." *Id.*, at 14; S. Rep. No. 792, 73d Cong., 2d Sess., 12 [(1934)].[38]

The proxy provisions function as an overlay to state law in the field of corporate suffrage. See Loss, *The SEC Proxy Rules and State Law*, 73 Harv. L. Rev. 1249 (1960). State corporate law identifies the circumstances in which matters must be put to a vote of shareholders, authorizes the directors or other persons to seek proxies from shareholders, and provides remedies for violations of state-law duties in connection with such corporate

[37] Such an analysis has roots in the tort-law concept that for a plaintiff to recover for a statutory violation, his injuries must be of the type the statute was designed to prevent. See *Gorris* v. *Scott*, 9 L.R.-Ex. 125 (1874). Similar principles have been applied under federal regulatory statutes. See *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977); *Atlantic Richfield Co.* v. *USA Petroleum Co.*, 110 S. Ct. 1884 (1990) (both cases defining antitrust injury under the Clayton Act, 15 U.S.C. 4, by reference to the purposes of a particular antitrust prohibition).

[38] See also *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 431 (1964); *TSC*, 426 U.S. at 444.

action. Federal law defines the disclosure obligations that attach to the proxy-solicitation process and ensures that elections and other corporate voting matters are carried out in accordance with federal regulations prescribed "as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. 78n(a).[39] The proxy rules thus work in tandem with state law to protect investors' rights; the proxy rules do not override the fundamental role of the States in regulating corporate governance, but serve to guarantee that the processes provided by state corporate law are meaningful ones.[40]

2. In light of those purposes, we believe that several types of "nonvoting" causation are sufficient in an action under Section 14(a).

a. A shareholder may be induced by a defective proxy statement to vote in favor of a transaction, thereby precluding his resort to an appraisal remedy under state law. Where appraisal is afforded, States uniformly require that the shareholder vote against the proposed corporate transaction as a prerequisite to asserting dissenters' rights. See 2 Model Business Corp. Act Ann. § 13.21, at 1394 (1985) (statutory comparison). A shareholder who forfeits such rights as a consequence of a deficient

[39] Stock exchanges may also require listed companies to solicit proxies for all stockholder's meetings. See New York Stock Exchange Constitution and Rules (CCH), ¶ 2565, at p. 4239-4240 (1990) (reproducing § 802.00 from NYSE Listed Company Manual); American Stock Exchange Constitution and Rules (CCH), ¶ 10,195, at p. 3722 (1989) (reproducing § 705 from AMEX Company Guide).

[40] An additional purpose of the proxy rules is to see that shareholders are adequately informed about corporate activities. See S. Rep. No. 1455, 73d Cong., 2d Sess. 74 (1934) ("In order that the stockholder may have adequate knowledge as to the manner in which his interests are being served, it is essential that he be enlightened * * * as to the major questions of policy, which are decided at stockholders' meetings."). Section 14(c), which was added to the Exchange Act in 1964, 78 Stat. 570, carries forward this purpose by requiring that when an issuer is not soliciting proxies (typically where the minority shareholders' votes are unnecessary), it must distribute an information statement to shareholders, containing the information that would be contained in a proxy statement. 15 U.S.C. 78n(c). Such information statements may not be false or misleading as to any material fact. See 17 C.F.R. 240.14c-6.

proxy statement clearly suffers loss "caused by" the violation of Section 14(a).[41]

b. Similarly, a shareholder's ability to enjoin a corporate transaction in state court may be frustrated by false proxy disclosures. Such a chain of causation has long been recognized in damages claims under Section 10(b) of the Exchange Act and Rule 10b-5.[42] Permitting such a theory does not convert the proxy process into a state-court discovery device (Pet. 21); it simply recognizes that authorization for a corporate transaction can be blocked, even by a minority, based on facts revealing a violation of state law. If the source of those facts is accurate disclosure as required by federal proxy rules, the purposes of the proxy rules and of state law are furthered. Hence, a shareholder should be permitted to show that he was denied the opportunity to enjoin the action for which shareholder authorization was sought.[43]

[41] See, *e.g.*, *Cole* v. *Schenley Industries, Inc.*, 563 F.2d 35, 40-41 (2d Cir. 1977); Note, *Causation and Liability in Private Actions for Proxy Violations*, 80 Yale L.J. 107, 117-118 (1970). Cf. *Swanson* v. *American Consumers Industries, Inc.*, 475 F.2d 516 (7th Cir. 1973) (claim that proxy statement misled shareholders into voting for transaction, resulting in loss of their statutory appraisal rights, stated a cause of action under Rule 10b-5).

[42] See, *e.g.*, *Healey* v. *Catalyst Recovery of Pennsylvania, Inc.*, 616 F.2d 641, 647 (3d Cir. 1980); *Alabama Farm Bureau Mutual Cas. Ins. Co.* v. *American Fidelity Life Ins. Co.*, 606 F.2d at 614; *Kidwell ex rel. Penfold* v. *Meikle*, 597 F.2d 1273, 1290-1294 (9th Cir. 1979); *Goldberg* v. *Meridor*, 567 F.2d 209, 218-220 (2d Cir. 1977), cert. denied, 434 U.S. 1069 (1978); *Wright* v. *Heizer Corp.*, 560 F.2d 236, 250 (7th Cir. 1977), cert. denied, 434 U.S. 1066 (1978). See also *Madison Consultants* v. *FDIC*, 710 F.2d 57, 64-65 (2d Cir. 1983); see generally Note, *Suits for Breach of Fiduciary Duty Under Rule 10b-5 After* Santa Fe Industries, Inc. v. Green, 91 Harv. L. Rev. 1874 (1978).

Moreover, this Court stated in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 474 n.14 (1977), that the shareholders' concession that "under Delaware law they could not have enjoined the merger" indicated that the omitted fact alleged in that case was not a material one.

[43] The lower courts have disagreed on how strong a showing of likelihood of success in such a state action is required to establish causation. See Gelb, *Rule 10b-5 and* Santa Fe – *Herein of Sue Facts, Shame Facts, and Other Matters*, 87 W. Va. L. Rev. 189, 209 (1985). In many cases, however, the showing necessary to establish that a disclosure was false or misleading and material will necessarily determine the facts that would have entitled the shareholders to state-court relief.

c. Beyond those forms of causation, the proponents of corporate action may for a variety of reasons by unwilling to proceed with a transaction on the same terms if truthful disclosure is made in their proxy statement. A company may have an established policy not to force through certain transactions or proposals without minority approval. Alternatively, the facts surrounding a particular transaction may demonstrate that the controlling shareholders view the minority's approbation necessary as a practical matter.[44]

3. The foregoing causation theories are fully compatible with the view that the shareholders' injury under Section 14(a) must arise out of "distortion of the voting process." Pet. 20. The voting process, fully and fairly understood, encompasses not only the casting of ballots. As in any election, much important activity occurs before the vote and can affect its outcome, even where a majority appears firm. The ability of shareholders to use information in a proxy statement to secure judicial remedies under state law—to postpone or block a vote, or to change the proposal—is encompassed within the voting process. Likewise, the impact that a vocal minority can have—whether through publicity, threat of contingent liability, resort to government intervention, or simple suasion of a majority desirous of consensus—is also part of that process.[45] These causal theories, therefore, are consistent with Section 14(a)'s purposes.

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[44] Such considerations may stem from a desire to minimize contingent liability to dissenting shareholders under state appraisal remedies, see, *e.g.*, *Cole* v. *Schenley Industries, Inc.*, 563 F.2d at 39-40, or from a desire to avoid adverse publicity that might result from truthful disclosure. See, *e.g.*, *United States* v. *Margala*, 662 F.2d 622, 626-627 (9th Cir. 1981) (sustaining a criminal conviction for proxy violations based, in part, on the fact that adverse publicity regarding fraudulent scheme would have blocked the transaction); *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d at 384 ("We cannot assume that even a rapacious controlling management would necessarily want to hang its dirty linen out on the line[.]").

[45] This theory gives substantive content to the premise, underlying enactment of the federal securities laws, that disclosure has a deterrent effect. See Douglas, *Directors Who Do Not Direct*, 47 Harv. L. Rev. 1305, 1324 (1934) ("The prophylactic effects [of publicity] will equal in importance any other single measure which can be adopted."); Frankfurter, *The Federal Securities Act: II*, 8 Fortune 53, 55 (1933); see also Securities and Exchange Commission, *Disclosure to Investors: A Reappraisal of Administrative Policies Under the '33 and '34 Acts* 10 (1969) ("[A]ppropriate publicity tends to deter questionable practices and to elevate standards of business conduct"); Cf. L. Brandeis, *Other People's Money and How the Bankers Use It* 92 (10th printing 1934) ("Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.").

In contrast, injuries based on the theory that a misleading proxy statement affected the market price of publicly traded shares, and harmed investors in their trading, should not be recognized as satisfying the causation requirement under Section 14(a). See *Cowin* v. *Bresler*, 741 F.2d 410, 427 (D.C. Cir. 1984). Section 14(a) focuses on the solicitation of proxies in order to authorize corporate action, not on an investor's trading decisions.[46]

B. The Court Of Appeals Applied An Incorrect Causation Theory

Although causation can be established where the minority shareholders lack dispositive voting power, the causal theory applied below was incorrect. The court of appeals sustained liability on the theory that causation was shown because the proxy was an "essential link" in the transaction. Pet. App. 14a. As the court appeared to use that term, its analysis was incorrect.[47]

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[46] Petitioners argue (Pet. 21-22) that just as tender offerors were held, in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), not to be within the class of persons Section 14(e) protects, minority shareholders without voting power are not within the class Section 14(a) protects. Section 14(a), however, has as one of its "chief purposes" the protection of *all* shareholders. *J.I. Case Co.* v. *Borak*, 377 U.S. at 432; see *TSC*, 426 U.S. at 448. In *Piper*, the Court concluded that Congress specifically intended to preclude bidders from bringing damages actions against target companies under the Williams Act. Here, in contrast, nothing evinces a congressional intent to deny minority shareholders a remedy for deceptive proxy materials aimed at them.

[47] The court of appeals also held that individual reliance is not required in an action under Section 14(a), and the certiorari petition does not challenge that holding. As applied to this case, we agree that a shareholder need not establish that the misleading statement induced him to support the proposal. If the shareholders were unable to block the transaction because the defendants withheld or misstated material facts, the violation caused their injury, regardless of the absence of individual reliance. In this respect, reliance generally does not play the role in proving causation under Section 14(a) that it plays under Section 10(b). Cf. *Basic Inc.* v. *Levinson*, 485 U.S. at 243. In Section

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The "essential link" test derives from this Court's decision in *Mills*, where the votes of the allegedly misled shareholders were necessary to approve a particular transaction. The Court stated: "Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction." 396 U.S. at 385. The *Mills* "essential link" test is thus shorthand for a theory that permits causation to be inferred when the violation was likely to have influenced the votes of shareholders whose approval was necessary to consummate the transaction. Such a presumption, which responds largely to the practical problems of proving the result of a hypothetical election, see *ibid.*, does not apply to a case in which minority shareholders lack the votes to affect the contest's outcome.[48]

The jury instructions in this case, however, permitted a finding of causation if the proxy solicitation was an "essential link" in the accomplishment of the merger, and required for that finding only that the solicitation of minority shareholders was "necessary." J.A. 426. Accordingly, the judgment, to the extent that it depends on the validity of those instructions, cannot stand.[49]

10(b) cases, involving fraud in connection with the purchase or sale of securities, individual reliance is needed to link plaintiff's trading decision to the violation. In contrast, in a proxy-violation case, "[t]he damage suffered results not from the deceit practiced on [plaintiff] alone but rather from the deceit practiced on the stockholders as a group." *J.I. Case Co.* v. *Borak*, 377 U.S. at 432.

[48] Likewise, we do not believe that minority shareholders are entitled to a presumption of causation under the alternative causal theories we have discussed above, as the problems of presenting direct proof encountered in *Mills*, 396 U.S. at 385, are not present. Cf. *Basic Inc.* v. *Levinson*, 485 U.S. at 245 (discussing purposes of presumptions).

[49] We express no view as to whether petitioners have properly preserved this claim of error, or whether, if they have, the case should be reversed outright or remanded for a new trial based on an alternative causation theory.

CONCLUSION

The jury was properly permitted to determine whether the proxy statement was materially false or misleading. But the judgment below was in error to the extent that it permitted the jury to find causation solely on the basis that the statement was "necessary" to accomplish the transaction.

Respectfully submitted.

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* The Solicitor General is disqualified in this case.

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